

ALEXANDER (J. W.)

LIFE ASSURANCE

BY

JAMES W. ALEXANDER



A Paper read before the National Convention of Insurance
Commissioners at Detroit, Michigan
September, 1899

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Yielding to the courteous request of the heads of the American Insurance Departments to submit a paper at the National Convention of Insurance Commissioners, to be held in Detroit in September, 1899, on the subject of "Life Assurance," I do not propose to enlarge upon those questions which have become so familiar as to be almost trite, but rather to direct attention to certain fundamental principles of management which underlie the permanency and integrity of the institution of life assurance as conditioned by the times, the place and the circumstances, in which we are called upon to solve our problem.

In addressing myself to the interesting and important theme selected, it will be my purpose to avoid whatever might be suspected as due to a competitive spirit, and in good faith to study what is for the best interests of the business at large, and, therefore for the policyholders, and therefore for the individual companies.

This remark leads naturally to another one, namely: that much that is difficult to handle in the careful management of the affairs of a life assurance company is complicated by competition in making the wares we have to sell easily salable to the buyer, who is often incompetent to look below the surface or further than the present. It is idle to attempt to stifle competition. Measures intended to have that effect are liable to accomplish too much, and unduly to embarrass and restrain. For it cannot be gainsaid that while some evil may result from too much license in competition, much benefit may also result from legitimate competition; and hard and fast rules, no matter how honestly framed, may do more harm than good.

There is room for legitimate competition in the skill with which the respective companies are managed, in such respects as the forms of policy; the ingenious combinations of figures within the proper limits of safety and cost of handling; the methods of propa-

ganda; the care and improvement of funds; the employment and payment of agents, and other particulars. But there are certain fundamental principles upon which it would seem reasonable to expect the intelligent and honorable men of experience who hold the responsible positions in the direction of our life assurance companies, to come to some agreement, and which ought, for the sake of the vast number of prospective widows and orphans, to be taken out of the field of competition.

In speaking of these subjects, I earnestly disclaim intending to strike at any particular companies or their methods, although necessarily the application may be inevitable to those who are versed in the methods of the various organizations. On the other hand, I am not to be understood as parading any supposed superior wisdom on the part of the management with which I happen to be connected. We are none of us infallible. I concede the same honesty of purpose to my neighbors which I claim for myself. And the present study is entered upon with a genuine desire to learn and disseminate the truth, and nothing more. It may not be inappropriate to say that at this juncture it seems to me most desirable that the leaders in our sacred vocation should sit down together and endeavor, without reference to the temporary advantages of a brilliant new business, much of which is ephemeral, to reach sound conclusions on the essential subjects referred to, entering upon such consultation with the sole intention of protecting the lasting interests of the policyholders whose interests have been entrusted to us.

Leaving out of consideration, then, the many phases of the business which have often been discussed, and in regard to which errors may be committed without materially affecting the integrity of the business, let me proceed at once to the more vital questions.

To be general, at the outset, and particular later: I am convinced that the tendency of life assurance competition to-day is dangerously in the direction of overstraining in giving what are called "privileges" to the assured, as distinct from pure and simple assurance. The rivalry takes the form of trying to see how many extraordinary benefits can be promised to the assured, often with possible danger to the company. This is a complete reversal of the spirit which controlled the management of com-

panies thirty or forty years ago, and unless moderated is likely to lead to unfortunate results.

During and before the sixties the reputable companies charged a full premium; frowned on cash surrender values; moderated the amount of paid-up assurance allowed on surrender, so as not to remove entirely the wholesome penalty to the unfaithful; confined the business to salubrious regions, except at rational extra rates, and all this at a period when high interest was obtainable on the best forms of investment, and when the expenses of the business had not been forced to a high percentage through hot competition.

It was during such times that the policyholders were best protected, and that the most gratifying returns were made by mutual companies to their policyholders.

The spirit of competition has led to many abuses (as well as to many improvements) in the conduct of the business. A curious craze took possession of the community some years ago for getting assurance at the cheapest obtainable rates. Those versed in statistics know what calamities resulted from this. I will not dwell on the dark history of assessment assurance, under which hundreds of thousands of people were induced to rely upon a rope of sand and to believe that they could be protected by a contract utterly at variance with the teachings of science and experience. The story is too well known to need specifications. But the lesson ought to be taken to heart by us who are responsible for the management of the great life institutions which should be an example to all, of prudence, caution and foresight. The endeavor which has been repeatedly made, and generally with disaster, to furnish assurance at the minimum present cost to the policyholders, has been fraught with a peril that should not be permitted to encumber a contract which may run through thirty, forty, or even fifty years; through changing administrations and personnel, and has to be completed with the beneficiaries whom the policyholder leaves behind him, and not with himself. It is not wise to drive too close to the precipice.

Then, this same spirit which exhibited itself in the management of the assessment companies, and the "cheap companies," began to crop out among the companies charging an adequate premium and working on the mutual plan. An extreme desire

to give costly "privileges" as enhancing the attractiveness of the policy contract was evinced. Offers of loans on policies; extraordinary cash surrender values; free permits to court disease and death in heretofore prohibited localities, and in hazardous occupations; adherence to rates of interest in computing premiums and reserves more liberal than conservative opinion justified, and even definite engagements to pay more cash on surrender of a policy than the reserve on the policy itself computed in accordance with the rate of interest assumed in the calculation of the premium. In other words, the policy contract has been, by this company and by that company, handicapped with conditions tending to weaken its strength, and perhaps to bring it into the domain of the questionable. This ought not to be, and it is not too late to mend the matter.

Coupled with all this, and running parallel with it, and most naturally and most excusably so, has been a disposition on the part of legislatures, of the press, and of the Insurance Departments, to show too great a sympathy, perhaps, with this spirit in regulating the companies, and in devising measures to compel companies to go to extremes in the direction I have referred to.

Let me explain, for here is a very important feature of the whole discussion. Who has ever heard of a Legislature framing laws to keep down the amount of surrender values *contracted* for? Who ever heard of a newspaper or an Insurance Department doing so? (Just here the distinction must be made between surrenders *paid* and surrenders *contracted* for. To pay *after* it has been demonstrated that the company can afford it, and to *promise* to pay *before* future conditions are known, are two very different things, and the distinction is vital. A company's very existence may depend on it.) Who ever heard of a Legislature or Department seeking to compel companies to charge high rates for service in war, or to forbid assurance against suicides, or to make smaller dividends, or to charge extra rates in the poisonous regions of the tropics, or to abstain from what is known as "extended insurance" on surrender (which is term assurance—the most hazardous—without medical examination), or to take out of its policies provisions which tend to sap the surplus-producing or strengthening power of the company?

One tendency of supervision, with all its acknowledged ad-

vantages which are numerous and effective, has been to emphasize the requirements which give *temporary* privileges to policyholders, and to bear lightly on the conditions which work for *ultimate* security and profit. Do not let me be misunderstood. The splendid work done by the departments in holding all companies to strict accountability, and making it most difficult for careless or designing managers to violate the laws or to dishonor accepted honest principles, is too well known to require any encomium from me. Our affairs are conducted in the blaze of so many search-lights that we are subjected to a scrutiny unknown in other spheres of business—commercial or financial—and wilful mismanagement is made so perilous, and is so sure of detection, that only the most reckless would venture to take the chances of discovery. What I am referring to is the bias of mind, honestly acquired by reason of the trend of public discussion and the practice of the business. The companies themselves have by their habit of action made it appear to the gentlemen, who—generally from other walks of life—assume the supervision of the scientific practice of life assurance, that the best company is the one which gives the greatest promises for the smallest amount of money. *That* is the radical idea which we ought to get out of our heads—companies and departments alike. It would be preferable to take the other extreme, and commend the company which gives the least promises for the most money. Both these propositions, however, are intentionally made somewhat crude for the purpose of contrast. The instructed mind will readily supply the qualifying conditions necessary to make them practical.

It should be remembered that the policyholders of a company whose business is conducted on the mutual plan are not mere *customers*, whose interest is to see how little they can put into the company and how much they can get out of it, but they are *members* interested in the prosperity of the company, in maintaining its security and in increasing its earnings and thus lessening the cost of their assurance. If three hundred thousand men are assured in a life company and the premium paid by each policyholder is on the average \$5 less than it ought to be, the company will suffer to the extent of \$1,500,000 a year. If, on the other hand, policyholders invest on the average \$5 more than is

absolutely necessary as shown by subsequent experience, the company will secure an annual advantage of just \$1,500,000 and the fund produced by this excess of payments invested and compounded from year to year will rapidly increase; the company will be stronger; its business will be more profitable; the dividends of each member will be increased directly and indirectly through the influence of this increased amount of capital invested by them in their business; they will ultimately receive more than the excess of their payments, and they will be the gainers. It is not extravagant, therefore, to say that if an applicant for assurance should be restricted to a single question with reference to a mutual company offering him assurance, it would be wiser for him to ask "How large are the premiums which those who associate themselves with one another in this mutual organization are required to deposit for the mutual benefit of all?" rather than to ask: "For how small a premium can I purchase this assurance?" As the public grow more and more familiar with the business of life assurance, it will not be surprising if the time shall come when men of substance who are businesslike and exact in their transactions with other people, and who exact similar accuracy and promptness on the part of those with whom they deal, will refuse to submit to the pecuniary losses which fall directly upon them through the many favors now granted by life companies to the improvident, the careless, the trifling, and the slipshod, who are ready to accept all kinds of favors without making any return for them—it would not be surprising to me (I say) if men of this kind, who are engaged in wholesale pursuits, lead healthy lives, reside in safe places, ask for no indulgence, make their payments promptly, need and desire no expensive privileges (and the vast majority of those who assure in the best companies belong to this category) should come to the companies and should say: "Place us in a class by ourselves, and give us the benefit of the profit which will result from the improved mortality which will certainly ensue, and the saving which will result from the reduced risk assumed in our behalf; then we shall be willing to agree that if at any time we desire any special privileges, or are forced to incur any unusual risks, we shall be charged and pay the proper cost therefor."

Now, what are the principles to which attention should be

drawn to-day, with a view to concert of action among the companies?

First, I would answer, the rate of interest to be assumed in computing premiums, with a sufficient loading for expenses and contingencies.

Until recently, four per cent. has been considered a conservative rate to assume. One company had the foresight to adopt a three per cent. basis some years ago, and is entitled to credit for the same. Some companies have adopted a three and one-half per cent. basis on a part of their business. Others have very recently adopted a three per cent. basis on a large part of their business, and a three and one-half per cent. basis on the remainder. A change all around to three per cent. on the new business exclusively will ultimately solve the problem of a gradual change on all business to the new rate, because new business rapidly supplants the old, and whatever may become necessary in regard to a change of basis of reserve on the old business, this gradual process is in the right direction. It is recognized that while some companies have enough assets as compared with reserve to make the change on old business at once, there are others which would be embarrassed if compelled to do so, and it would not be equitable to enforce the change abruptly without corresponding measures making the transition feasible.

There continues a disinclination in some quarters to make the change to three per cent. on all new business. This arises, not from lack of conviction that the course is dictated by prudence and is desirable, but from a reluctance to make the increase in premiums necessarily involved if the change is to be made on a sound basis, and thus to remove one of the alluring features which help the agent to sell his wares. Here competition enters to blind the eyes of wisdom. At least, this is my opinion.

Why is three per cent. as high a rate as should be assumed by conservative companies? It would seem that the proposition needed no argument. It is patent. The standard of Massachusetts, the pioneer in careful insurance supervision, was four per cent. when seven per cent. was readily obtainable on the best real estate mortgages and the best railroad bonds. New York followed suit in 1887, and made the standard four per cent. at a time when six per cent. was easily obtainable on high-class

securities. The margin was not considered any too wide. Errors in investment had to be provided for. Idle money and money temporarily held at minimum rates had to be provided for. It was never regarded as prudent to assume a rate which might *probably* be obtained on the average, but which was not by any means certain. An examination of the rates actually obtained by the six largest companies reporting to the State of New York in the year 1897 shows that they averaged 4.74 per cent., while the ruling rate at the same time for good mortgages on real estate was 4.80 per cent., and yet this margin was far greater than can be expected now. Money is freely loaned on first-class real estate in New York, Boston, Philadelphia, Pittsburg, Chicago, St. Louis and other cities at four per cent., and even lower rates are accepted in particular cases. United States Government bonds are selling at prices which will yield the holders only 2.20 per cent. to 2.45 per cent. upon their investment. The better class of railroad securities are selling on a three to three and one-half per cent. basis. Quite a large number of the railroad companies in the country have been engaged in refunding their bonds as they mature by the issue of three and one-half per cent. bonds, and, in the case of the Chicago & Alton and others, are issuing three per cent. bonds. The three and one-half per cent. bonds so issued are selling at a premium of from six per cent. to ten per cent. Municipal bonds of some of the largest of our cities are selling on a basis of 2.90 per cent. to 3.15 per cent., and even bonds of smaller cities well located sell readily upon a basis of 3.05 per cent. to 3.25 per cent. Savings banks throughout the country have quite generally been obliged to cut down the rate paid to depositors to correspond with the recognized decline in the rates obtainable on good investments. This rate, which, a few years ago comparatively, stood at five per cent., has been reduced to an average of three and one-half per cent., although there are many of the savings banks still paying four per cent. on small deposits, they being able to do so owing to the great advance in the price of securities held by them as investments. One of our largest life assurance companies in the East, which had steadily adhered to a demand of five per cent. on real estate mortgage bonds, has recently announced its intention to loan freely at four per cent. We also find that one of the large com-

panies in the West, which has been loaning money at high rates and has deservedly claimed the credit for earning high rates of interest, has, within a year, loaned millions of dollars on Chicago and St. Louis property at four per cent.

Desiring to learn the opinion of the best instructed minds in the country on the probabilities of the future as to the rate of interest on which a life insurance company could absolutely count, without peradventure, I addressed a letter to each of over two hundred financiers and economists, asking his opinion. Out of one hundred and fifteen replies, sixty-five say three per cent. or less, seven going as low as two and one-half per cent.; thirty-six say from three per cent. to three and one-half per cent.; seven say from three and one-half per cent to four per cent.; one says from three per cent to four per cent.; two say what may be regarded as four per cent. qualified in some way, and only four say four per cent. unqualifiedly. According to the concensus of opinion of these experts, therefore, it would not be safe to assume more than three per cent. as a guarantee for the future.

Among those giving three per cent. as the maximum *which should be absolutely counted on without peradventure*, were men like:

Lyman J. Gage, Secretary of the Treasury of United States, Washington.

C. N. Jordan, Assistant Treasurer, United States, New York.

James H. Eckels ($2\frac{1}{2}$ per cent.), Commercial National Bank, Chicago.

J. R. Walsh, President, Chicago National Bank, Chicago.

J. C. Van Blarcom, Vice-President, National Bank of Commerce, St. Louis.

Walker Hill, President, American Exchange Bank, St. Louis.

John B. Jackson, Fidelity & Trust Company, Pittsburg.

Edwin L. Porter ($2\frac{1}{2}$ per cent.), Vice-President, Mercantile Trust Company, Pittsburg.

John H. Holliday, President, Union Trust Company, Indianapolis.

J. P. Frenzel, President, Indiana Trust Company, Indianapolis.

J. W. Lusk, President, German American Bank, St. Paul.

Ryerson Ritchie, President, American Trust Company, Cleveland.

S. M. Clement, President, Marine Bank, Buffalo.
C. A. Sweet, President, Third National Bank, Buffalo.
William Alvord, President, Bank of California, San Francisco.
Levi P. Morton, New York.
D. O. Mills, New York.
August Belmont, New York.
Kuhn, Loeb & Company, New York.
Merritt Trimble, President, Bank for Savings, New York.
John A. Stewart, President, United States Trust Company, New York.
John Harsen Rhoades, President, Greenwich Savings Bank, New York.
Wm. Endicott (2 $\frac{3}{4}$ per cent.), New England Trust Company, Boston.
J. F. Downing, President, New England National Bank, Boston.
S. F. Tyler, President, Fourth Street National Bank, Philadelphia.
Drexel & Company, Philadelphia.
C. J. Bell, President, American Security & Trust Company, Washington.
A. Baldwin, President, New Orleans National Bank, New Orleans.
P. Romare, Vice-President, Atlanta National Bank, Atlanta.
S. P. Read, President, Union and Planters' Bank, Memphis.
J. S. Carr, First National Bank, Durham, N. C.
If you will examine the returns of the various companies for the last year you will find that among the largest companies the actual percentage realized on total assets ranged from 4.24 per cent. to 5.16 per cent. And it must not be overlooked that these rates were reached by including vast amounts of outstanding loans at five and six per cent., and even some old ones at seven per cent., and including gains on sales of securities. It is not too much to take for granted that even at present ruling rates the experience of the companies will be less favorable as old investments are replaced by new.

How dangerously near the safety line, then, shall we be if we assume a three and one-half per cent. basis, instead of a three per cent. basis! And how incumbent it seems upon us to create an

absolutely safe margin between the rate we assume and the rate we hope to get! For it must be observed that the assumption of a prudent basis does not preclude us from using our best endeavors to do better. And if it should happily prove feasible for us to earn four per cent., the difference in a mutual company will go back to the policyholders, while during the period of uncertainty it furnishes one of those guarantees of security which ought to be a *sine qua non* in this unique business of ours, which reaches out into the unknown future.

So much for interest. The next principle is that which is involved in excessive surrender values, especially in the early years, and in the contract-features which stimulate disintegration rather than encourage persistence. In old times, surrender values were unknown. Afterwards they came into vogue on a moderate scale. Now they threaten the healthy continuance of policies. Formerly when a man was financially embarrassed he had to sell, whatever his health might be. Now, he *sells* if in good health, *borrow*s if in poor health, and if seriously deteriorated *he takes extended term assurance, stops the payment of premiums, and the claim is collected*. To begin with, it is a fallacy to assume that because for convenience of calculation the reserve on each policy is computed as appurtenant to that policy, the amount of the reserve in each case is in equity the property of the particular policyholder before his policy matures, as distinguished from being the property of the mass of policyholders, of which he, of course, is one. It is not. The equity of the transaction is that the policyholder should continue his contract to the end. If he does not, he just so far does all that in him lies to break up the combination upon the continuance of which as a whole the safe operation of the laws of mortality and finance depends. This man has no inherent right to draw out the proportionate amount of the combined security fund that on the average may be back of his contract. The erroneous idea that he has this right is at the root of the competition which has led to excess in this direction. One man cannot be a company all by himself. It requires great numbers to secure the averages. And whoever, after being one of the number banding together to secure beneficial results for the whole, backs out and repudiates his share in the enterprise, ought to be subjected

to a proper penalty. History will show that a rigid practice in this particular has a salutary effect. Besides, the object and aim of assurance companies is not to take care of the living people who become tired of paying, or for other reasons (even in cases of hardship) abandon their contracts. The objects of our solicitude are the widows and orphans who are deserted by these improvident people, and for their sakes we ought to make it less easy for their husbands and fathers to leave them in the lurch.

Nowadays, it seems as if the ingenuity of man was almost exhausted in devising ways and means to neutralize the beneficial work of life assurance. We take great pains to obtain a new policyholder, and spend much money to that end. One of the inducements we offer him is an easy and profitable means of exit. We move heaven and earth to get him in, and then offer him tempting rewards if he will get out! We preach the duty of providing a portion for the widow and orphan, and then turn round and tempt him to mortgage the policy, and to that extent blot out the good we have done!

I am not advocating the abandonment of surrender values, but I am putting the question baldly so that it may be clear. Most assuredly, the surrender values given should be moderate, especially in the early years, and should be in general in the shape of paid-up assurance and not cash. The company with which I am connected cannot accomplish what is here advocated without the co-operation of others, and it is the excesses which competition in this direction lead to, that demand intelligent criticism and condemnation.

The only other principle to which I propose now to refer is the insurance of hazardous risks without an adequate extra premium.

It must be conceded that this is of direct advantage only to those who actually incur the special hazard provided for, and only very remotely to those who have no reason to anticipate that they will ever be exposed to such extra hazard. It is universally conceded also that the assumption of extra hazard necessarily increases the cost of assurance. In a mutual company, therefore, all the members are compelled by this practice to pay for that which can be of material advantage to only a small minority, and the principle of mutuality is distinctly violated. The

essence of this principle is, that the payments made by the members to the company shall be as nearly as possible proportional to the risks incurred. For this reason alone the premiums are graded according to age, in accordance with the experience recorded in the Mortality Table. Why is the applicant at age fifty required to pay a higher premium than the applicant at age twenty-one? Simply because the company incurs a greater risk in accepting the one than in accepting the other. The older applicant must pay an adequate extra premium for the extra hazard incurred in his behalf. What would be thought of a company which advertised that in order to make its policies more liberal it would henceforth accept applicants above fifty at the premium heretofore charged for age twenty-one? Would this be genuine liberality, notwithstanding the fact that to every man there would be a possibility of his ultimately being able to avail himself of it? What would be the effect upon a strong company if it were to adopt this plan? Would it not soon be crowded with applicants above fifty? If the privilege were extended to its other policyholders on their attaining the requisite age, it might also greatly stimulate for a while applications at younger ages, but as the public began really to understand the matter, would it not become very difficult to obtain applications from those who were considerably below fifty? Old members would be attracted and young members repelled, and the average age of the membership would rapidly increase, and with it the annual death losses and the cost of assurance to all the members. Ultimately the company would be avoided by all because of insecurity.

This is, of course, a very extreme supposition, but extreme cases often enable us to see clearly the principles involved.

*Equal premiums for unequal risks not only violate the principle of mutuality, but also do not come within the scope of genuine liberality. If they are liberal to those who incur the greater risk, they are, *pari passu*, illiberal to those who do not. And they are subject to the fatal objection that, when well understood they attract inferior risks and repel superior ones; and, therefore, their ultimate effect upon the company is deterioration in its membership.*

The object of grading premiums according to age, of subjecting applicants to medical examination, of making conditions to exclude applicants who intend to commit suicide, of charging

extra premiums for extra hazardous risks, is in each case one and the same, namely, to proportion the cost to the risk incurred, and to carry out the principle of mutuality between the members. If it be genuine liberality to remove the barrier against those who may intend to commit suicide, why is it not equally meritorious to remove the barrier against those whose health may be impaired? The errors are the same in kind, and differ only in degree. If suicides were as common as unhealthy people, the one error might lead to as serious results as the other.

The company that admitted all ages at an average premium, or older ages at a premium that measures the risk for a young age, would soon become a company of old members; the company that required no medical examination would rapidly tend to become a company of sick members, and in like manner the company which admitted abnormal risks without adequate extra premium would, if the public fully understood the subject, be ultimately abandoned to the abnormal risks.

In a brief paper like this it is only possible to indicate lines of thought and argument, but it is important that it should be known that there are those engaged in the business of life assurance who are ready and willing to confer with others similarly engaged, with a view to reaching conservative usages in essential matters, and to guard the business in every possible way, so that competition may be confined altogether to those features which do not strike at the root of security and permanence. How are these objects to be attained? By legislative enactment or by the enforcement of rules by the Insurance Departments? I answer emphatically, by neither of these instrumentalities until those thoroughly versed in the business have come to conclusions as to what is best, but much can be done in discussion, and by the attention of intelligent men given to these far-reaching subjects.

The institution of life assurance is one which appeals to the noblest sentiments, and from the motives behind it should be absolutely shorn all those selfish considerations which ordinarily actuate the conduct of rivals in every-day commercial affairs. Unfortunately, the prestige of a life assurance company with the agents and policyholders has been too much represented as depending on the maintenance of a large annual new business, and this stimulates so-called "liberality" in contracts and measures.

In order, therefore, that each company may in good faith apply the principles of safety and permanency to the transaction of the business, in the most effective form, co-operation seems absolutely requisite. It is in the hope that the honorable men who guide the various life assurance companies of this country may, after adequate discussion, reach the conclusion that it is both wise and morally their duty to wrest from the field of competition all those fundamental principles, the disregard of which will prove detrimental to the best interests of the assured, that I invite your attention, and, through you, the attention of the assurance world, to these grave considerations.

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